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In the
Supreme Court of the United States

CATERPILLAR INC., CATERPILLAR FINANCIAL SERVICES CORPORATION, AND SOLAR TURBINES INCORPORATED,
Petitioners,
v.
THE NEW HAMPSHIRE DEPARTMENT OF REVENUE ADMINISTRATION AND STANLEY R. ARNOLD, JR., THE NEW HAMPSHIRE COMMISSIONER OF REVENUE,
Respondents.

On Petition for A Writ of *Certiorari* to the Supreme Court of New Hampshire

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BRIEF OF *AMICI CURIÆ* BUSINESS AND INDUSTRY ASSOCIATION OF NEW HAMPSHIRE AND NEW ENGLAND LEGAL FOUNDATION IN SUPPORT OF PETITIONER

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MOTION OF AMICI CURIAE BUSINESS AND INDUSTRY ASSOCIATION OF NEW HAMPSHIRE AND NEW ENGLAND LEGAL FOUNDATION FOR LEAVE TO FILE BRIEF IN SUPPORT OF PETITIONER

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Pursuant to Supreme Court Rule 37.2, counsel for *Amici Curiae*, who are employed by the New England Legal Foundation, have attempted to secure written consent for the filing of the attached Brief *Amici Curiae* from counsel for the Petitioners and Respondents. Although counsel for Petitioners granted such consent, counsel for Respondents withheld it. Accordingly, counsel for *Amici Curiae* hereby move this Court for leave to file the Brief *Amici Curiae* which is submitted herewith. *Amici* makes this motion on the following grounds:

Amicus Curiae the Business & Industry Association of New Hampshire ("BIA") is a statewide, membership driven organization, where leaders from varied business organizations come together in an effort to understand and affect public policy. The BIA solicits information, conducts research and analysis, provides a responsible forum to address problems facing New Hampshire's business community, and seeks to develop and present constructive solutions. The BIA's efforts are implemented through five professionally staffed member-oriented standing policy committees: Fiscal Policy, Human Resources, Environment, Economic Development and Energy Affairs & Regulated Industries. Findings and policy initiatives are then moved to the Board of Directors. The BIA serves the New Hampshire business community as the only statewide, nonpartisan voice representing the interests of all New Hampshire businesses, large and small, across all industries, on key issues and in every public policy forum.

Amicus curiae New England Legal Foundation ("NELF") is a non-profit, public interest law firm, incorporated in Massachusetts in 1977. Its membership consists of corporations, law firms, individuals, and others who believe in NELF's mission of promoting balanced economic growth for New England, protecting the free enterprise system, and defending economic rights. NELF's more than 130 members and supporters include a cross-section of large and small

corporations from all parts of the New England and the United States, including several multinational corporations. NELF has regularly appeared in state and federal court, as party or counsel, in cases raising issues of general economic significance to the business community. *See, e.g., Natsios v. National Foreign Trade Council*, 181 F.3d 38 (1st Cir.), *cert. granted*, 120 S. Ct. 525 (1999); *UNUM Life Ins. Co. v. Ward*, 526 U.S. 358 (1999); *BMW v. Gore*, 517 U.S. 559 (1996); *Reich v. Southern New England Telecommunications Corp.*, 121 F.3d 58 (2d Cir. 1997); *Georgine v. Amchem Products, Inc.*, 83 F.3d 610 (3d Cir. 1996); *Conservation Law Foundation v. Department of the Air Force*, 79 F.3d 1250 (1st Cir. 1996); *Preseault v. United States*, 66 F.3d 1167 (Fed. Cir. 1995).

Amici seek to bring to the Court's attention their views, and those of their supporters, concerning the proper taxation of income and interest from foreign subsidiaries of domestic corporations. If the decision below is not reversed, state taxing authorities will be encouraged to continue to overstate the income apportionable to their states and continue to tax foreign income at a rate higher than domestic income, discouraging foreign investment which is essential in our global economy.

Wherefore, BIA and NELF respectfully request that this Court grant *Amici Curiae* leave to file the attached brief in support of the Petition for a Writ of *Certiorari*.

Respectfully submitted,

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INTEREST OF *AMICUS CURIÆ*

Amicus Curiae the Business & Industry Association of New Hampshire ("BIA") is a statewide, membership driven organization, where leaders from varied business organizations come together in an effort to understand and affect public policy. The BIA solicits information, conducts research and analysis, provides a responsible forum to address problems facing New Hampshire's business community, and seeks to develop and present constructive solutions. The BIA's efforts are implemented through five professionally staffed member oriented standing policy committees: Fiscal Policy, Human Resources, Environment, Economic Development and Energy Affairs & Regulated Industries. Findings and policy initiatives are then moved to the Board of Directors. The BIA serves the New Hampshire business community as the only statewide, nonpartisan voice representing the interests of all New Hampshire businesses, large and small, across all industries, on key issues and in every public policy forum.

The New England Legal Foundation ("NELF"), a non-

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1. Pursuant to Supreme Court Rule 37.6, counsel for *amici* state that counsel for neither Petitioner nor Respondent authored this brief in whole or in part and no person or entity other than *amici* made a monetary contribution to the preparation or submission of the brief.

profit, public interest law firm, was incorporated in 1977. Its membership consists of individuals, businesses, and others who believe in promoting balanced economic growth for New England, protecting the free enterprise system, and defending economic rights. NELF's more than 130 members and supporters include a cross-section of large and small businesses from all parts of New England and the United States. NELF has regularly appeared in state and federal court, as party or counsel, in cases raising issues of general economic significance to the business community. *E.g., Natsios v. National Foreign Trade Council*, 181 F.3d 38 (1st Cir.), *cert. granted*, 120 S. Ct. 525 (1999); *UNUM Life Ins. Co. v. Ward*, 526 U.S. 358 (1999); *BMW v. Gore*, 517 U.S. 559 (1996); *Reich v. Southern New England Telecommunications Corp.*, 121 F.3d 58 (2d Cir. 1997); *Georgine v. Amchem Products, Inc.*, 83 F.3d 610 (3d Cir. 1996); *Conservation Law Foundation v. Department of the Air Force*, 79 F.3d 1250 (1st Cir. 1996); *Preseault v. United States*, 66 F.3d 1167 (Fed. Cir. 1995).

Amici seek to bring to the Court's attention their views, and those of their supporters, concerning the proper taxation of income and interest from foreign subsidiaries of domestic corporations. If the decision below is not reversed, state taxing authorities will be encouraged to continue to overstate the income apportionable to their states and continue to tax foreign income at a rate higher than domestic income, thus undermining the ability of United States companies to compete and discouraging foreign investment, both of which are essential in today's global economy.

SUMMARY OF ARGUMENT

This Court should grant Caterpillar's Petition and answer the questions left unresolved by this Court's prior decisions dealing with state taxation of intangible income from

foreign subsidiaries.

Under New Hampshire's "water's" edge approach, intangible income received by a United States parent company from foreign subsidiaries, such as the interest and royalty payments Caterpillar received, is included in the parent's tax base without "factor representation." No portion of the payroll, property or sales factors of the foreign subsidiaries is included in New Hampshire's apportionment formula. The New Hampshire scheme, thus, disregards the unitary business principle which provides the basis for New Hampshire's taxation of Caterpillar's activities outside its borders.

Contrary to the holding of the New Hampshire Supreme Court, Caterpillar's subsidiaries are not unrelated business entities and should not be treated as such. They should be treated consistently with Caterpillar's domestic subsidiaries and the appropriate portion of the foreign subsidiaries' payroll, property and sales factors should be included in the apportionment formula. Without any consideration of these factors, New Hampshire discriminates against foreign commerce, taxing it at a higher rate than domestic commerce, and discourages foreign investment.

ARGUMENT

THIS COURT SHOULD GRANT THE PETITION TO RESOLVE AN IMPORTANT QUESTION CONCERNING THE CONSTITUTIONALITY OF STATE TAXATION OF INTANGIBLE INCOME RECEIVED FROM FOREIGN SUBSIDIARIES OF UNITED STATES CORPORATIONS.

A. Under New Hampshire's "Water's Edge" Approach, Income from Caterpillar's Foreign Subsidiaries Is Included in Caterpillar's Taxable Income But No Portion of the Factors Which Generated that Income Is Included in the Apportionment Formula.

The facts are stipulated. Caterpillar is a Delaware corporation having its principal place of business in Illinois. During the tax years in dispute, Caterpillar owned over 50 foreign and domestic subsidiaries. Caterpillar stipulated that it and all of its subsidiaries were engaged in a single "unitary business" as defined in N.H. RSA 77-A:1, XIV. Only three of the corporations, the petitioners, conducted any business in New Hampshire. According to Caterpillar, this business activity "was limited to the ownership of personal property located in New Hampshire and the solicitation of sales to unrelated, independent dealers in New Hampshire." Petition at 6.

New Hampshire apportions the income of a "unitary business" between New Hampshire and all other states using a formula based on three factors: (1) the "property" factor, which compares tangible property owned in New Hampshire to tangible property owned everywhere; (2) the "payroll" factor, which compares payroll in New Hampshire to payroll everywhere; and (3) the "sales" factor, which compares New

Hampshire sales to sales everywhere. These fractions are averaged and the resulting fraction applied against the total taxable income of Caterpillar's unitary business to determine the amount that is apportioned to, and taxable by, New Hampshire.

Before 1987, New Hampshire applied this unitary business principle on a worldwide basis. In 1987, New Hampshire amended its tax code and limited the business profits tax to the "water's edge" by eliminating foreign business organizations from this tax. Under the New Hampshire scheme, like those of many other states, income earned by foreign subsidiaries is excluded from the calculation of a unitary business' combined net income that is subject to apportionment. However, in the year in which income from foreign subsidiaries is returned to Caterpillar in the U.S. in the form of interest and royalty payments, it is included in the Caterpillar's unitary business income. Under New Hampshire's "water's edge" approach, none of the factors that generated that income are considered.

New Hampshire's inclusion of the interest and royalty income from foreign subsidiaries without "factor representation" — inclusion of some portion of the costs incurred by the foreign subsidiaries — violates the Commerce Clause because it discriminates against foreign commerce, taxing it more severely than income of domestic subsidiaries, and violates the Due Process Clause because it vastly overstates New Hampshire income by abandoning the unitary business principle.

B. Intangible Income from Foreign Subsidiaries Is Apportionable Because the Foreign Subsidiaries Are Part of Caterpillar's Unitary Business, Not Unrelated Businesses.

"[I]t is fundamental that a State has no power to impose a tax on income earned outside of the State." *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 422, 451 (1980) (Stevens, J., dissenting). *Accord Norfolk & Western Railway Co. v. Missouri State Tax Commission*, 390 U.S. 317, 325 (1968). This principle rests on the constitutional requirement that there must be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954); *Mobil Oil* , 445 U.S. at 436-37. This doctrine "derives from the virtually axiomatic proposition that the exercise of a state's power over a taxpayer's activities is justified by the 'protection, opportunities and benefits' the state confers upon those activities." W. Hellerstein, *State Taxation of Corporate Income from Intangibles: Allied-Signal and Beyond*, 48 Tax L. Rev. 739, 745 (1993) (quoting *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940)).

A "unitary business" that has in-state and out-of-state activities provides the necessary "minimal connection." *Mobil Oil*, 445 U.S. at 439. Caterpillar stipulated that it was engaged in a unitary business with all its foreign and domestic subsidiaries. Accordingly, New Hampshire "must . . . apply a formula apportioning the income of [a unitary business] within and without the State." *Container Corp. v. Franchise Tax Board*, 463 U. S. 159, 169 (1983). That formula must, "under the Due Process and Commerce Clauses, be fair." *Id.*

This Court has established a two-part text of fairness:

> The first . . . component of fairness in an apportionment formula is what might be called internal consistency — that is, the formula must be such that, if applied in every jurisdiction, it would result in no more than all of the unitary business' income being taxed. The second and more difficult requirement is what might be called external consistency — *the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.*

Id. (emphasis added). This Court has approved the "three factor" formula used by New Hampshire and many other states. This Court has also held that states may constitutionally include intangible income from foreign subsidiaries in the apportionable income of a unitary business. *Mobil Oil*, 445 U.S. at 441.

This Court has not resolved whether inclusion of that income without any factor representation is constitutionally permissible. *Container Corp.*, 463 U.S. at 168 n. 5. Justice Stevens, in his dissent in *Mobil Oil*, squarely addressed the issue and expressed his opinion that it is not.

> Unless the sales, payroll and property values connected with the production of income by the payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause Mobil's Vermont income to be overstated.

Mobil Oil, 445 U.S. at 461 (Stevens, J., dissenting). He reasoned that

> Either Mobil's worldwide 'petroleum enterprise' . . . is all part of one unitary business, or it is not; if it is, Vermont must evaluate the entire enterprise in a consistent manner.

Id. To evaluate a worldwide unitary enterprise consistently, Justice Stevens concluded that the payroll, property and sales of the foreign subsidiaries must be taken into account. *Id.* at 462.

The New Hampshire Supreme Court concluded, however, that the Department treated Caterpillar's unitary group — consisting of only the domestic subsidiaries — consistently and held, without analysis, that the Department properly considered the foreign subsidiaries as unrelated businesses that paid interest and royalties to Caterpillar.

Foreign subsidiaries, however, are not unrelated businesses in which Caterpillar has invested or to which it has licensed technology. They, like the domestic subsidiaries, are part of a unitary business.[2] Being part of that unitary business is what subjects their payments of interest and royalties to taxation in New Hampshire. As prominent tax commentators have explained:

> When . . . the formula gives no recognition to the payroll, property, and sales of the entities that helped generate the apportionable income, and whose unitary relationship to the payor provides the predicate for apportionability, there

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2. Interest and royalty income from unrelated businesses would be taxable by New Hampshire only if "the capital transaction" serves an operational, not investment, function. *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U. S. 768, 787 (1992).

> ceases to be a rational relationship between the income being taxed and the activities that give rise to the income. In short, a state should not be able to have it both ways: including income of subsidiaries in the parent's apportionable tax base on the theory that the parent and the subsidiary are engaged in a unitary business but then apportioning such income by factors reflecting only the parent's own operations on a separate company basis.

Jerome R. Hellerstein & Walter Hellerstein, State Taxation ¶9.15[2] at 9-118 (3d ed. 1998). This reasoning applies equally to foreign and domestic subsidiaries. *Id.* at ¶ 9.15[4][c] at 9-141.

Without some factor representation, the income apportioned to New Hampshire from the interest and royalty payments of Caterpillar's foreign subsidiaries (with which New Hampshire has no connection and upon which it confers no benefits), is out of all proportion to Caterpillar's activities in New Hampshire. It is not apportioned, as constitutionally required, in a manner which "actually reflect[s] a reasonable sense of how income is generated." *Container Corp.*, 463 U.S. at 169.

New Hampshire's inclusion of intangible income from foreign subsidiaries without any factor representation also "treats foreign source income less favorably than it treats domestic source income." Hellerstein & Hellerstein, *supra*, ¶9.15[4] [c] at 9-141. As Justice Powell noted in his dissent in *Container Corp.*, "such a tax has the effect of discouraging investment in [foreign] countries." 463 U.S. at 202. Investment in foreign countries, critical in today's competitive,

global economy, should be encouraged by fair taxation of income from foreign subsidiaries, not discouraged by New Hampshire's unfair "water's edge" scheme.

CONCLUSION

For the foregoing reasons, and those set forth in Caterpillar's Petition, this Court should grant the Petition, and take this opportunity to answer the questions left open in *Mobil Oil* and *Container Corp.*, which will provide much-needed guidance to state taxing authorities and taxpayers as well.

Respectfully submitted,

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Dated: February 22, 2000